RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

May 20, 1987 **LETTER 965**

May 8 DJIA 2322.30; PTI 2576; A-D Ratio -5.71
May 15 DJIA 2272.52; PTI 2574; A-D Ratio -6.38

THE PICTURE: You know, it really is a tragedy. I've been writing about this for over a decade, but there seems to be no way that the political bums in Congress will ever cut back on federal spending. Year after year this country has produced these disgraceful and immoral deficits, spending four bucks for every three it takes in -- all in the name of keeping the US "prosperous" (and, of course, keeping the constituents happy and voting for their favorite spenders).

But in the end the market has its way of dealing with economic immorality. It's called "declining prices." Over the last few years the sacrificial lamb of declining prices has been the US dollar. The once "almighty" dollar has gone down the drain to the tune of almost 50% in terms of the leading hard currencies.

This year the dollar has been joined by another sacrificial lamb -- the bond market. After all, there's a limit to how long people (specifically, foreigners) will hold bonds when the currency those bonds are denominated in (dollars) is sinking into the sunset.

Then there's the matter of interest rates. When bonds go down interest rates go up, and I don't give a damn what the Fed or the Treasury or anyone else says or does about it. So that's what's been happening the past few months -- the bonds have been going down and interest rates have been going up. When interest rates go up, mortgage rates go up, and the prime rate goes up, and every other rate goes up (all this, mind you, in the name of our great "on-the-tab" prosperity).

How will it all end? It ends this way: The stock market gets frightened, and it starts to descend to safer ("more sustainable") levels. And when the stock market and the dollar and the bond market all go south, well — the American consumer begins to get scared. And you know perfectly well what happens then. We call it a recession. If it gets totally out of hand, we call it a depression.

As I said at the beginning, it's really a tragedy. But if and when the trouble hits (and ultimately it will hit), the American people will blame the "irresponsible politicians in Washington" for wrecking the finances of the nation. And the politicians will whine that "we gave the voters what they wanted -- or why else would they have voted for us?" And the market, in its cold, logical way won't give a hoot about who's right or wrong. The market will just go about its business of discounting the future, and as I see it, the future could be kind of difficult before the next year or so is out.

THE MARKET: I've been writing about the question of the primary trend of the market ever since the yield on the Dow dropped into the over-valued 3% area (where it has been sitting during most of 1987). Why spend so much time and energy on the primary trend? Because the single most important piece of information that you can have about the market is the direction of the primary trend.

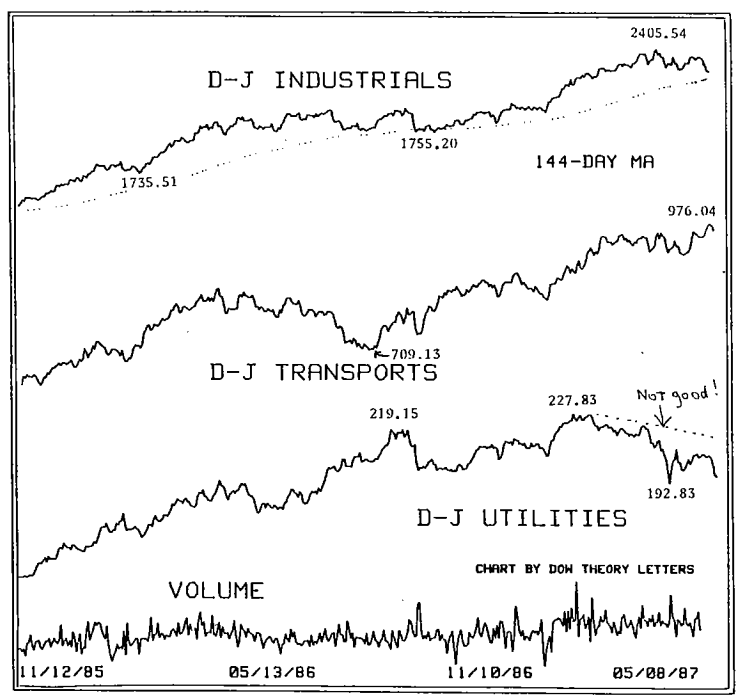
For the benefit of our many new subscribers, let me explain. If the primary trend is bullish, then all mistakes, all rotten buys, all poor judgments will (in due time) be bailed out by the power of a rising tide in the market. Conversely, if the primary trend is bearish, then only holders of cash, shorts, or (sometimes) gold will fare well. All others will find their net worth moving relentlessly into the loss column, due to the power of the receding tide. My general rule during primary bear markets is this: "The winner is he who loses the least."

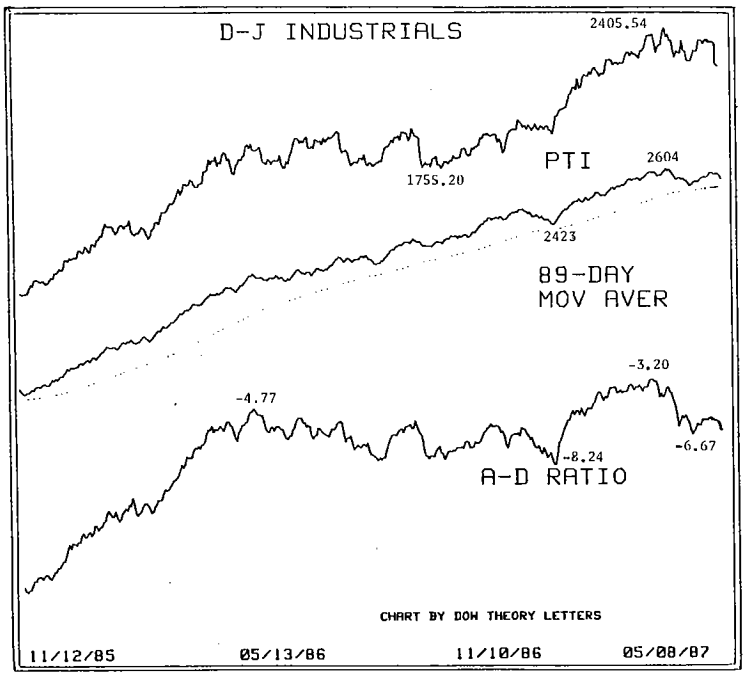
In recent years I have stated repeatedly that our position is that *"the primary trend of the market remains bullish until proved otherwise."* Then a few months ago I wrote that in view of the overvaluation in the market, I wanted to make a change in our policy. From now on we were going to insist that *"the market prove itself."*

How do you make the market prove itself? Easy, we welcome every decline, and the reason we welcome a decline is that we want to see what happens AFTER the decline. If the stock averages, following a decline, can gather the strength to rally to new highs, then we have fresh proof that the primary trend of the market remains bullish. But, following a decline, if the Averages (specifically the D-J Industrial and Transportation Averages) fail to rise to new highs, then we know that something is wrong and that either a full correction or a primary bear market is in the wings.

In the last Letter I listed the critical high points (see page 1 chart) for the Averages. The high points were 2405.54 for the D-J Industrials, 961.48 for the D-J Transports. Those bull market highs are essential in determining the direction of the primary trend. A bettering of BOTH those peaks by the two Averages would constitute the "all clear" flag for the market, and, of course, such a signal would also be a reconfirmation of the primary bull trend.

However, I stated that if one or both Averages fail to better those highs, the situation will become rather critical. For if the Averages then turn down and violate the late-April reaction lows of 2230.54





for Industrials, 908.03 for Transports, a primary bear market will be signaled.

So what happened? On April 28, following a three-week correction, the market started up again. On May 6 the D-J Transportation Average rallied to a record high of 964.64. That new high was not confirmed by the Industrial Average (to confirm, the Industrials would have to rally above 2405.54). Again on May 13 the Transports spurted to a new record high of 967.49, and again the Industrials refused to confirm.

AS MATTERS NOW STAND, THERE ARE ONLY TWO POSSIBILITIES. If the lagging Industrials can gather strength and advance above 2405.54 (thus confirming the Transports) the primary trend of the market will be reconfirmed as bullish. Conversely, if the two Averages decline from here and violate their recent lows (2230.54 on Industrials and 908.03 on Transports), a primary bear market will be signaled.

As this is written neither event has occurred. Consequently, at this time there can be no decisive classification of the primary trend. The fact is that there is no more confusing period than one which finds the Averages backing-and-filling in that "no-man's land" between the last primary high points and the most recent secondary low points. But like it or not, that's where we now are. It remains for the Averages to tell us whether we are still in a bull market -- or whether a bear market has started.

Because the technical situation is so important at this juncture, I am listing below the various late-April lows for your information and verification. It is important that these low points hold if a bear market is to be averted:

D-J Industrial low	2230.54
D-J Transport low	908.03
D-J Utility low	192.83
S & P 500 low	279.61
NYSE Comp low	158.31
PTI low	2550
A-D low	-6.67

FURTHER TECHNICAL NOTES: Referring to the point & figure chart on page 2 of the last Letter, the Dow on May 5 rallied above the 2300 box on the chart. On a P & F basis that advance turned the chart bullish again with a "count" or price target for the Dow of 2500. It would take a drop to 2260 to turn the Dow bearish again on this chart.

My Primary Trend Index (PTI) has kept me out of trouble for 16 years. As you can see on the page 2 chart, the PTI is still bullish, having refused on its most recent decline to sink below its 89-day moving average. I've said it a hundred times, but I'll say it again -- "We always stay on the right side of the PTI." Today, the right side of the PTI is still the bullish side. In other words, as far as stocks are concerned, you can be 30% long, you can be 50% long, you can be 75% long -- but the PTI is telling you that you better not be short this market, not until we have real evidence that the trend of the PTI has turned decisively down.

One of the items to watch now is the advance-decline ratio. I noted in the last Letter that the A-D ratio (which is a proxy for the entire NYSE) lost over two-thirds of its 1987 gains during the March-April sell-off. Furthermore, the rally in the A-D since the April 27 low has been unimpressive. Feeble breadth at this late stage in the bull market is not a good sign. From here on, the action of the A-D ratio is going to tell us a lot about the strength (or weakness) of this market.

The following valuable observations are from my old friend, Bob Powers of Robert S. Powers Investment Service located here in San Diego. Powers notes that since 1895 there have been 12 Dow advances of 40% or more that were not interrupted by corrections of 5% or more. The last of these uncorrected advances ended approximately one year ago. Writes Powers, "NONE of these movements, including the most recent one, marked the end of the bull market.

"To develop a target date and level for when the current bull market might end, we calculated the mean and the median duration and amplitude of the advance to the final bull market highs following the conclusion of the eleven previous uncorrected 40% upswings. That calculation yields a target range of 2344-2651 for the next bull market peak on the DJIA, with the most likely time frame being between August 1987 and February 1988. Last month the DJIA moved above 2400. Consequently, we have now reached the target range but are a few months shy of the most likely time frame."

INVESTMENT POSITION: It's becoming tedious to repeat this, but our one-horned bull remains in the box. It's still a bull market, but that single horn tells us that it's a tiring bull.

I've stated that when the Dow is in the "below-3% yield zone" it's hard to make money in the stock market. With the A-D ratio having wiped out most of its 1987 progress, my guess is that the average portfolio is now about even, a little ahead or just a bit under water -- not too great for all 1987's excitement. The Dow and the big capitalization averages hit their highs on April 6, so even if you owned the right stuff, you would be down in your portfolio over the last month.

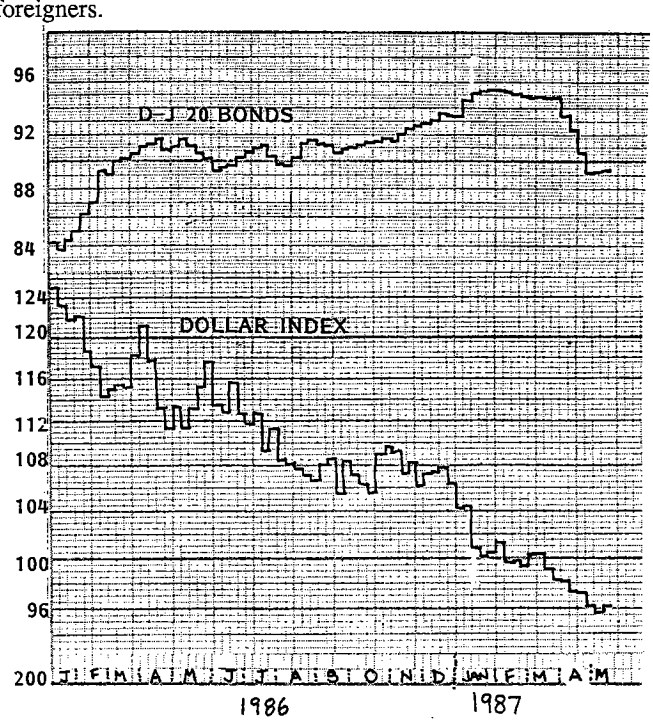
So mid-May finds us waiting to see whether we're in a bull market or something less pleasant. It's waiting time, the time that investors hate more than any other. But the stock market won't be hurried. Wall Street marches to its own drummer.

Advice: Continue taking profits. The spill in the bond market and the higher interest rates provide an attractive area for money. The area is AA-rated muni bonds issued by your state (if you have state taxes in your area). You can get a tax-free 5-6% for bonds maturing in five years or less. Or you can put the money in a muni cash fund, yielding 4.5% to 5%. A risk-free, tax-free 4.5% -- with the Dow yielding a taxable 2.85% and the S&P 500 yielding a taxable 2.96%. Mull it over.

BONDS, RATES, DOLLARS: The story is in the charts. Here we see the almost uninterrupted decline of the dollar via the Dollar Index, which is weighted heavily towards the mark and the yen. As the dollar declines, foreign holders sustain huge losses in dollar-denominated items -- principally bonds. Consequently, they

want more incentive for buying or holding US bonds, and the incentive is the return on the bonds or HIGHER rates.

As you can see, the bond market ignored the collapsing dollar until 1987. So far this year the bonds have dropped approximately 12% across the board, and pessimists are talking a still lower dollar. Personally, I believe the dollar is now fundamentally undervalued, but it's a case of supply and demand. Behind the supply are the US deficits, deficits which must be sold in part to foreigners.



However, every dog has its day and every decline has its ending (or at least its upward correction). It's purely my own opinion, but I feel that the dollar is very near to reversing to the upside. The major foreign currencies appear to me to be topping out (amid a flurry of TV commentators' talk of "new fortunes to be made" by buying the yen and the mark).

DOW THEORY: I started these reports 29 years ago back in 1958. In those days I wrote exclusively about stocks (no bonds, gold, commodities, economics, notes & quotes), and I based the Letters almost entirely on classic Dow Theory.

I learned Dow Theory from the writings of one of the great market minds of all time, Robert Rhea of Colorado Springs, Colorado. Back in the 1930s Rhea published an advisory called "Dow Theory Comment," and due to his expertise and amusing writing style, he developed a wide following. Rhea began publishing his reports in mid-1932 and his writing career ended with his untimely death in late-1939. Rhea was a close student of Charles H. Dow, the man after whom the Dow Theory was named. But of even more help to Rhea was William P. Hamilton, the brilliant second editor of the Wall Street Journal.

Rhea's fame began when he called the bottom of the great 1929-32 bear market -- called it to the exact day on July 8, 1932. Rhea also called the top of the big 1932-37 bull market, and he got his subscribers out prior to the disastrous 1937-38 bear market. I became a student of Rhea's -- in a strange way (as I will explain shortly).

Many people have asked me how I first got into the study of the Dow Theory. So here's a little history. After World War II (having spent four years in the infantry and the Army Air Force), I went back to college and got my degree. Although I was an English/business major, I found it difficult to land a job in 1946 (as did most other veterans).

The stock market was very much out of favor in the '40s. In fact, of my entire graduating class, I knew only one person, a fellow named Morris Gratz, who went to Wall Street. Morris worked at Bache. He became a broker mainly to please his wealthy family (it was decided that Morris was to be the family's Wall Street representative).

So back in the '40s I used to sit with Gratz at Bache's largely empty boardroom, located on 44th St. at Lexington Avenue in Manhattan. The more I watched the market and the tape, the more enamored I became of the whole world of Wall Street. Then one of my neighborhood buddies, Henry Spector, got a job down at the old New York Mercantile Exchange (at that time the Merc traded cotton, eggs, and potatoes). Henry's job was to stand at the Merc's huge blackboard and chalk in the price changes as they were called in. I would bring my lunch down to the Merc and watch with fascination as Henry entered the prices -- eggs, potatoes, cotton -- my mind boggled at the excitement of it all.

A year or so later, I started going with a beautiful girl whose family was steeped in the stock market. Her father and both of her older brothers owned seats on the NYSE, and her uncle owned a seat on the Curb (now the AMEX). Her oldest brother became a close friend of mine, and it wasn't long before I was totally absorbed with the market. I even picked up Wall Street's "market-babble" vocabulary -- Bessie, Big T, Chessie, Big Steel, the Curb, fill or kill, stop-buy, and so forth.

But one thing bothered me. Neither I nor anyone else seemed to know what really made the market tick. True, my girl's father and brothers were active and successful floor traders (they were specialists), but they were only interested in what stocks were doing this minute or this hour. As for an overview, as for the main trend of the market, they weren't really concerned (although like every broker, they loved the excitement and action of a bull market). But their basic interest was today's market, their order books, and, above all, their commissions.

So in my further efforts to understand the market, I began searching through the books at New York's great main public library on 42nd Street. The 42nd Street library boasts a huge economics section with a selection of stock market books second to none. Day after day I would sit in the economics section, sifting through their catalogue, ordering book after book pertaining to the stock market. Nothing, no book that I read, satisfied me as to how the market worked. In frustration, I kept calling for more and more books. I felt that somewhere there had to be an answer.

Then one day I came across a volume entitled "Dow Theory Comment" by Robert Rhea. I dove into that volume, and the more I read, the more fascinated I became. The library had collected the complete series of Rhea's reports written during the fascinating and difficult period of 1932 to 1939. I read and reread those reports. And I was amazed. Here, for the first time, I discovered market writing that seemed to make sense. Robert Rhea, marvel of marvels, really knew how the stock market worked. Rhea's comments were brilliant, and best of all, I could check what he wrote in his advisory with what actually occurred in the market weeks and months later.

I became more than fascinated, I became obsessed. I read Rhea's work over and over again. I memorized sections of his letters. I typed hundreds of his market comments on 3-by-5-inch index cards. Then I cross–filed the cards. If I wanted to know about non-confirmations or dull volume or secondary reactions, I had dozens of Rhea's comments throughout the years all indexed. I read through the Rhea papers so often that the pages became ragged. I grew dizzy from studying Rhea's Dow Theory observations. At one point, I started to believe that I was the reincarnation of Rhea himself.

All right, I guess you get the idea. I learned Dow Theory through studying the writings of a man I never met. But in two intensive years of study I learned the Theory thoroughly, and I grew to have great respect for the Dow Theory.

Later I met a gentleman who was not only a great Dow Theorist but quite an innovator. He added a good many technical studies to what he termed his "improved Dow Theory." His name was George Schaefer, and he published a stock market report out of Indianapolis. Schaefer was an outstanding market practitioner with an absolutely extraordinary understanding and feeling for the primary trend. Schaefer, like Robert Rhea, made a good deal of money for his subscribers. I read and followed Schaefer with much of the same zeal with which I had followed Robert Rhea.

It's amazing to me how few of today's analysts and so-called experts really know anything about Dow Theory. Distressingly few of today's analysts have ever taken the time and trouble to actually study the Dow Theory. Almost every day I read an incorrect Dow Theory comment made by some well-meaning but misguided "expert."

At any rate, I started Dow Theory Letters out of frustration -- frustration because I was reading so many wrong statements about the Theory, and I wanted people to have access to the correct interpretation of Dow's Theory as I had learned it.

So in 1958 I started Dow Theory Letters. That same year I began writing a series of Dow Theory articles for Barron's. The series was successful, and happily it stirred up a good deal of interest in both the Dow Theory and the technical approach to the market. In fact, between 1958 and 1962 I wrote 17 articles for Barron's on the Dow Theory. Remember, in those days of the late-'50s and early '60s the technical approach was virtually unknown. Moving averages, momentum, relative strength, short interest ratios, odd lots, they were concepts most of Wall Street's analysts had never heard of. So I wrote about them.

By the end of 1962 I felt it was time to stop; I was tired of writing magazine articles, and I had my own reports to write. Furthermore, I wanted to give full time to my own new business. At that juncture I was particularly encouraged by George Schaefer, who told me that he felt that I was destined to take over the study of the Dow Theory from him some day.

George Schaefer died in 1974, during the terrible stock market decline. Sad to say, he never lived to see the great gold boom of 1980, a boom that he had predicted over and over again.

By October 1974 I became increasingly convinced that the great and disastrous bear market in stocks was about over. I felt very alone in my bullish opinions, and I found myself wishing that Schaefer was still alive so that he might confirm my contrary bullishness (with the Dow below 600 in late-1974, many experts were openly predicting 300 and 250 on the Dow).

In December 1974 I came out with my "Special Report" in which I opined that the great bear market was over, and that it was time to buy stocks again. I received hate phone calls, letters from men in the industry telling me that I would "regret my rash forecast," and many subscribers wrote to tell me that they thought I had finally lost my mind (toward the end of 1974 many market experts were openly predicting that the Dow was headed down to 250 or even below).

I countered by issuing lists of stocks to buy. It wasn't easy getting people to buy those fabulous bargains back in 1974 and early '75. At any rate, my 1974 "Special Report" proved to be not only a correct call but a profitable one. In the following year my business doubled, and once again the Dow Theory proved that it serves its followers well.

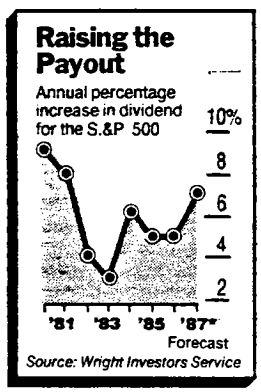
I owe my business and most of the money I have made over the past 30 years to the Dow Theory, to the genius of Robert Rhea, to George Schaefer -- and, of course, to the New York Public Library. Thanks, all of you.

STOCK YIELDS, DIVIDENDS: In the last Letter I noted that only once in stock market history has the Dow moved up substantially from an area where the Dow yield was at a low 3%. The one exception was in 1964 at which time the Dow yield dropped to 3% with the Dow at a 1964 high of 891. Yet despite the low 3% yield, the Dow continued to advance to a high of 995 in 1966 -- at which time the Dow yield was still 3%. How could the yield remain the same with a further rise of 11% in the Dow? The answer: Sharply rising dividends during 1965 and '66.

Today the yield on the Dow is down to a minute 2.85%, almost a record low. Despite this, predictions from all quarters are for a higher Dow this year and next. And what is the dividend situation? I think this piece from the May 10 New York Times tells an interesting story:

Disappointing Dividends

With those corporate rites of spring — annual meetings — drawing to an end, shareholders may have been left with great expectations. Annual meetings, like annual reports, are meant to put the company's best foot forward. But shareholders who expect higher dividends may be disappointed.



Some 9,812 corporate dividends were declared in the first four months of this year, according to Standard & Poor's, but only 626 of them were increases over last year.

This is discouraging news, says Michael Flament, vice president at Wright Investor's Service in Bridgeport, Conn. "Part of the case for a continuing bull market this year has been the expectation of a big increase in corporate dividends," he said. But of the companies in the Standard & Poor's 500 index that declared dividends in the first quarter, increases averaged "a paltry 3 percent" over a year earlier, Mr. Flament said.

The first quarter's strong profits and the lower corporate rates under the new tax law should have added up to healthy increases, he says. But many companies — uncertain about the economy and interest rates — are being cautious.

By yearend, he said, despite an anticipated 15 percent to 20 percent increase in corporate profits for 1987, "dividends should rise a conservative 7 percent." Last year, when earnings did not increase at all, dividends rose 5 percent.

Mr. Flament believes this year's relatively small dividend rise could lead to more stock market corrections. "It will take far more than the modest rate of dividend increases now indicated to support today's level of stock prices," he said.

"BEYOND OUR MEANS": That's the title of an excellent new book by Alfred Malabre, Jr., economics editor of the Wall Street Journal (Random House, $17.95). The subtitle provides some idea of the contents. The subtitle reads, "How America's long years of debt, deficits and reckless borrowing now threaten to overwhelm us."

This little 161-page book is well worth the reading, if for no other reason than the last chapter which begins with four words, "How will it end?" In this chapter Malabre gives his idea of how the whole economic mess might or could end. One way is for us to "pull in our belts and begin living, for the first time in a long time, within our means." He gives this little chance of happening.

Another solution would be hyperinflation, but Malabre gives this the least chance of occurring -- a probability rating of 20%. Then Malabre turns to the deflation scenario, and he gives this scenario a 30% chance of coming about.

Finally, rather surprisingly, Malabre then states that the most likely scenario is a massive government "involvement." In other words, Malabre feels that the government involvement during the next economic fiasco will probably be greater than that which occurred during the New Deal.

How about the federal debt? Says Malabre, "My guess is that the government debt will be repaid, and the deficit effectively erased, in a manner tantamount to default -- or confiscation. Holders of Treasury securities coming due may be told, for instance, that unless their bills, notes or bonds are rolled over, Uncle Sam will pay only a specified fraction of face value. Interest payments on such securities may be capped. That would amount, of course, to repudiation of a large part of the federal debt and would require legislative action."

OK, don't look at Richard Russell -- I'm not going to argue. In fact, I'm not sure that Malabre isn't 100% right! Malabre goes further: "How can investors protect themselves if this scenario does unfold? There's little that can be done. If hyperinflation were the likeliest prospect, one could readily hedge against it by investing in such tangibles as gold and real estate. If deflation were highly probable, bonds of top-rated companies and even cash would be in order. But the prospect of spreading governmental control over the economy -- over our lives-- is another matter. Black markets become much more attractive, of course. ... Legally, however, there's little that individual investors can do to protect themselves against an encroaching Washington presence."

Is this true? Will the frustrating mess that Malabre foresees come about? Is this what all our investing, all our planning, all our savings will come to? Frankly, I suspect that Malabre is going to be right. If so, the Russell opinion is that the thing to do is have a nice house, a batch of gold coins, an education, a good sense of values (as well as a sense of humor) and an abiding faith that God's in his heaven and somehow everything will work out in the end.

At any rate, I got a lot out of this book and I think you will too.

NOTES & QUOTES: Who needs stocks in a bull market? In 1977 (when it looked like Exchange specialists were going to be legislated out of existence) the price of a NYSE seat got as low as $30,000 bid, $40,000 asked. A few weeks ago an Exchange seat sold for a record $1.1 million -- a rise of 2400% in 10 years. Try doing that with stocks (see chart).

* *

In Tokyo, seats on the exchange go for $5 million (that's right, five million). Part of that is because of the recent big interest from British and US brokers, partly because there are only 93 seats on the Tokyo exchange (compared to 1,366 seats on the NYSE). Item: Two weeks ago Daiwa Securities of Tokyo paid $361,000 for a seat on the Toronto Stock Exchange. Talk about global markets, we're seeing 'em!

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Success: Biggest movie of 1987 so far: "Platoon" with a gross of $126 million. And in my opinion, worth every dollar of it.

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Office Rent: In Silicon Valley (CA) rent runs about $4 a square foot per year. In San Francisco's better neighborhoods you'll pay $25 a foot. In Wash. DC office rent runs around $30 a foot. In NYC office rent is $40 to $50 a foot. On top of that, NYC is the only US city to hit you with a rent tax of 6%.

* *

Quote of the Week (by Bob Lutz, VP at Chrysler): At 240 yen to the dollar, America was obviously doomed, completely wiped out as a manufacturing nation. At 150 yen, we at Chrysler were broadly competitive on cars landed in the US. At 140 yen, Toyota and the best of the Japanese manufacturers are still finding ways to make their exports profitable. At 120 yen, the Japanese will hit their death level —120 yen will really clean them out."

* *

The best business over the last few years has probably been starting a mutual fund. In 1986 alone the number of mutual funds rose 25% to 2,000. Along with all the new mutual funds, more than 20 new closed-end funds were formed. Charles Allmon started his Growth Stock Outlook Trust, and easily sold $140 million of his new closed-end fund (he told me that he could have sold $300 million). Mario Gabelli and Marty Zweig, perhaps encouraged by Allmon's start, both floated closed-end funds, and Marty brought in an astounding $320 million.

In case you didn't know, closed-end funds are just that -- closed. They are holding companies and their shares are traded just like any other stock. For instance, if you buy the Zweig fund you buy it on the NYSE from a seller, and your purchase in no way affects the assets of the fund. But if you buy a mutual fund, you buy it from the fund itself, and your dollars increase the total assets of the fund (but not, of course, the net assets per share).

But there's a problem. In a bear market the operators of a closed fund can sit, no matter what the market does. But a mutual fund can be subject to redemptions, and if 2,000 mutual funds are subject to forced liquidation in the next primary bear market we're going to see something new and exciting.

* *

Remark of the week by Robert Nicholson of the Nicholson Growth Fund: "You know there's something wrong when there's only one stock consistently on the Big Board's new low list -- and you own it. And you know there's something wrong when your prayers no longer concern your children each night -- and you find yourself praying for your portfolio."

* *

China: The greatest threat in China is the population explosion. In 1949 China's population was 540 million; it is now 1.1 billion. The one-child marriage law in China was instituted to hold back the birth rate. Since boys are revered in China and one child is the law, killing of girl babies became a fairly common crime. In Chongquing, one of China's major cities, 2,800 cases of girl-killing were under investigation in 1984. A second Chinese problem: Careening wages. Wages were up 16.7% in the first quarter of 1987, and the Chinese government blamed large bonuses for the rise.

* *

Japan's external (foreign) investments will exceed $500 billion by the end of 1987. This is greater than OPEC's at its peak! In 1986 the biggest chunk of Japanese investments went into bonds — $45 billion into US bonds (governments, fed agencies, and corporates) and $20 billion into Eurodollar bonds. So you can see that the fall in the US dollar is driving Japanese buyers of US bonds up the wall.

* *

Speaking of Japan, next month the Japanese will begin trading in options on the Osaka Exchange. This will add fuel to the already unbelievably overpriced Japanese stock market (overpriced due to a tidal wave of surplus yen). The average prospective P/E ratio (price of a share divided by prospective 12-month earnings) is 75 compared with 15 in the US. More than 100 Japanese stocks now have prospective P/Es of over 1000!

* *

I've always hoped in my heart that the S. African situation would somehow be solved or at least that the racial situation would simmer down. That's not going to happen. In the recent all-white election the right wing National Party won 135 of the 178 parliament seats (it had previously held 127). Said Chief Buthelezi, head of the huge Zulu nation and the most moderate of the black leaders (considered by some blacks an "Uncle Tom"), "I fear for the future. The white electorate has given more justification to the arguments of those who say that only escalated violence can bring the whites to their senses."

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To me, the mutual fund business is beginning to border on the ridiculous. There are currently about 18 advisory services giving advice on funds, and some of them even have a column on the new funds. I received a service today that lists eight new funds which are being offered this month. Yes readers, Russell is starting to turn off on the mutual funds. Remember, all the mutual funds (there are 2,000 of 'em) are owned by the public.

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I keep getting questions about this, so here goes again: If you buy a muni bond mutual fund (no load) you are subject to both the trend

of the bond market and the ability (or inability) of the fund manager. If the fund manager does badly, you may never see your purchase price again. In other words, there is no maturity date on the bond mutual fund. Advantages of the mutual fund, however are (1) no commission or load charge, (2) good liquidity.

If you buy your munis via a unit trust, you will get your money back as the bonds mature or are redeemed. In a unit trust you are simply buying a diversified package of bonds. But there is a load charge, usually around 5-6%, and this is figured into the price when you ask for the current yield and the yield to maturity of the unit trust. However, the unit trust has a disadvantage in that if you sell it early, you will take a loss on that front-end commission charge of 5-6%. Unit trusts should only be purchased by those intending to hold the units to maturity.

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If you think Gary Hart is an original, read ""Capitol Hill in Black and White" by Robert Parker (Dodd, Mead). Parker, a black, was befriended by LBJ and spent 11 years as maitre d' of the Senate dining room. He also moonlighted as a waiter at many private DC parties. He offers amusing, funny, and often shocking stories about such notables as JFK, Robert Kennedy, Hubert Humphrey, Everett Dirksen, James Eastland, Adam Powell, and many others. A fascinating book and an insight into the civil rights movement.

NEXT MAILING: June 3

GOLD, PRECIOUS METALS: What is the case for buying or holding gold? First, I honestly don't think "fear of inflation" is the No. 1 rationale for holding gold. I say that because I'm skeptical about inflation being a major problem in the months ahead. As I've said before, I feel the money markets are now so sensitive to inflation that any big inflationary pick-up would send interest rates substantially higher -- thus killing off inflation before it ever gets started.

No, I feel the real rationale for holding gold today is that we are now enjoying one of the longest spans without a recession in post-war history. But, obviously, the longer we go without recession, the better the odds are that we are nearing one — and probably a rough one.

OK, but what's wrong with a recession? My fear of a recession (and I'm sure the Fed agrees with me) is that a recession will bring on a sharp contraction in tax receipts to the Treasury. If that happens, the federal deficit is going to climb wildly upwards. It's going to go off into space!

With a sharply increasing deficit, the dollar could turn weak, very weak. In which case, foreigners would avoid US financial instruments -- stocks and bonds -- like the plague. If foreigners were afraid to place their funds in US bonds or stocks, where would they place their liquid funds? The answer, I believe, is GOLD (and probably silver and platinum).

Now let's face it, Richard Russell isn't the only thinking man around. Hardly. The fact is that there are many intelligent investors, sophisticated traders, brilliant central bankers, smart foreigners, who can also envision what I envision. And they are saying to themselves, "Mmm, the dollar still looks weak. And I don't see any lasting or fundamental improvement in the US trade position. So what's going to happen when the US or the world economy finally turns down? If the US or world economy turns down, the dollar could turn a lot weaker. Mmm, so I guess I'll just increase my gold position (or reserves, if I'm a central banker) to maybe 5% of my total position. Why wait for trouble? I'll just start playing it safe and do a little diversifying now."

All right, now let's examine gold from a technical standpoint -- and let's discuss some of the longer term implications of the rise so far. I have brought this monthly chart of gold (courtesy of Dunn & Hargitt) up to date.

Gold ended its great 1970-80 bull market with a spearpoint peak and a record price of $850 (spot) in 1980. From the 1980 peak a bear market began. By 1982 gold had plunged below 300. Next, a corrective rally carried gold to 504 in 1983. From there gold declined to a bear market low of 284 in February of 1985.

From the 1985 low gold has been heading up, and last week gold pushed above the 460 level. The next target in the two-year-old gold bull market is the 504 peak of 1983. If gold can get above the important 504 peak that will be a major technical accomplishment. If 504 is bettered, the next major hurdle will be 567. The 567 level represents the HALFWAY level of the entire 1980-85 bear market, a bear market which took gold from 850 to 284.

If gold can better the halfway level of the entire bear market decline, the metal will have bullishly activated the 50% Principle. In that event gold would be in a position, technically, to mount a major attack on the old bull market high of 850.

In other words two upside levels for spot London gold are now of critical importance in this gold bull market. The first level is 504, the second and even more important level is 567. I might add that it would not be unusual for gold to back and fill and even correct before hurdling either of these critical levels.

Platinum: I like platinum. Platinum use is now outrunning supply. Mull this over. Last year the Free World produced 35.8 million ounces of gold while the Communist block produced 11.3 million ounces. Last year a total of only 2.9 million ounces of platinum were produced. And 70%-80% of that platinum was produced in two S. African mines, Impala and Rustenburg. Outside of S. Africa, there aren't any large sources of platinum.

The easiest way to buy platinum is via the one-ounce pure platinum Noble, a coin minted on the British Isle of Man. I like platinum, I've been buying the Nobles, and I recommend them. You can order the coins through your nearest coin dealer (the Nobles should sell at a price of roughly 5% above the spot commodity price).

LATE NOTES: At the close last week (May 15) it was announced that the Producer Price Index for April jumped 0.7%. In the face of this inflationary statistic the CRB Commodities Futures Index exploded up 11 points to 245, June gold rose over $10 to 475, bonds collapsed with the governments down as much as 2 points per bond, banks raised the prime for the third time in six weeks, and the Dow tumbled 52 points, the fourth biggest Dow-pointage drop on record. Is inflation about to return again and return big? Maybe, but I've been saying that this time the markets are SUPER SENSITIVE to inflation and inflationary statistics (such as the one received last Friday). And this time inflation will be greeted by sharply DEFLATIONARY action in the market (which is exactly what we saw last Friday). Thus inflation now breeds the seeds of its own destruction -- AND FAST!

Meanwhile, my subscribers have all the important points to watch (see page 2 listing). And please remember, it isn't the pundits and it isn't the experts and it isn't the current market geniuses who make the trend, it's the markets.